

Rul. 86-142, 1986-2 CB 60.

ISSUES

- (1) Are additional contributions made by the employer to reimburse the trust of a qualified plan for brokers' commissions on transactions involving plan assets deductible under section 162 or 212 of the Internal Revenue Code?
- (2) Are additional contributions to an individual retirement account (IRA) within the meaning of section 408(a) to reimburse the IRA for brokers' commissions on transactions involving IRA assets deductible under section 162 or 212?

FACTS

Situation 1.

A corporation established a plan for its employees. The plan is qualified under section 401(a) of the Code and the related trust is exempt from tax under section 501(a). The plan year and the taxable year of the employer are the calendar year.

The plan provides that the employer will reimburse the trust for brokers' commissions charged in connection with the purchase and sale of securities for the employees' trust. The employer, over the plan year, makes the maximum deductible contribution to the plan under section 404 of the Code. During the plan year, the employer makes additional contributions to reimburse the trust for the brokers' commissions paid by the trust.

Situation 2.

An individual established an IRA within the meaning of section 408(a) of the Code on July 1, 1985, and upon establishment contributed the maximum amount allowable as a deduction under section 219 for that year. Later, during 1985, the individual made additional contributions to the IRA to reimburse the account for brokers' commissions incurred in connection with the purchase of securities on behalf of the IRA.

LAW AND ANALYSIS

Section 162 of the Code allows a deduction for the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 1.162-10(a) of the Income Tax Regulations provides that no deduction shall be allowed under section 162 of the Code if, under any circumstances, the amounts may be used to provide benefits under a stock bonus, pension, annuity, profit-sharing, or other deferred compensation plan of the type described in section 404(a).

Section 404(a) of the Code allows, subject to certain limitations, a deduction for employer contributions under a stock bonus, pension, profit-sharing, or annuity plan, or for compensation paid or accrued under a plan of deferred compensation, provided that such contributions or compensation satisfies the provisions of section 162 or 212.

Section 1.404(a)-3(d) of the regulations provides that expenses incurred by the employer in connection with a qualified employees' plan, such as trustee's fees and actuary's fees, that are not provided for by contributions under the plan are deductible by the employer under section 162 of the Code (relating to trade or business expenses), or section 212 (relating to expenses for production of income), to the extent that such expenses are ordinary and necessary. Amounts that are not ordinary and necessary expenses are not deductible under section 162.

Rev. Rul. 68-533, 1968-2 C.B. 190, holds that a sole proprietor's payment of trustee's fees that were expenses not provided for by contributions under a qualified plan are deductible by the sole proprietor under section 162 or 212 of the Code to the extent that they are ordinary and necessary. Such expenses are deductible in addition to the maximum deduction for employer contributions under the plan allowable by section 404.

The principles enunciated in the regulations under section 162 of the Code are equally applicable to section 212, except that the production of income requirement is substituted for the business requirement. Section 1.212-1(e) of the regulations provides in part that section 212 of the Code does not allow the deduction of any expenses which are disallowed by any of the provisions of Subtitle A of the Code (relating to Income Taxes) even though such expenses may be paid or incurred for one of the purposes specified in section 212.

Brokers' commissions are not recurring administrative or overhead expenses, such as trustee or actuary fees, incurred in connection with the maintenance of the trust or plan. Rather, brokers' commissions are intrinsic to the value of a trust's assets; buying commissions are part of the cost of the securities purchased and selling commissions are an offset against the sales price. Accordingly, employer contributions to reimburse the trust for brokers' commissions are used to provide benefits under the plan of which the trust is a part and thus are not deductible under section 162 or 212. Similarly, if instead of making additional contributions to the trust, the employer paid the brokers' commissions directly to the broker, such amounts are treated as though they had been contributed to the trust and used to provide benefits under the plan. Such direct payments thus are not deductible under section 162 or 212.

Amounts contributed (or treated as contributed) to a plan are deductible subject to the rules and limits in section 404. This is the case without regard to whether the amounts are

used to pay brokers' commissions, administrative or overhead expenses (such as trustee or actuary fees), or cash benefits.

In situation (1), the employer's contributions to reimburse the trust for brokers' commissions are not deductible as a separate expense under section 162 or 212. Also, because such contributions result in the employer's total contributions exceeding the amount deductible under section 404 for the taxable year, such additional contributions are not deductible under section 404. Such contributions, however, may be deductible in future years under the carryover rules of section 404(a).

Section 219(a) of the Code provides that there shall be allowed as a deduction an amount equal to the qualified retirement contributions of the individual for the taxable year. Section 219(c)(1) provides that such contributions include amounts paid by or on behalf of an individual to an IRA.

Rev. Rul. 84-146, 1984-2, C.B. 61, discusses the deductibility of trustee's fees with respect to IRAs. It holds that, consistent with the rules governing deductions in connection with qualified plans, amounts paid by the IRA owner for such fees in connection with an IRA are deductible under section 212 of the Code to the extent they satisfy the requirements of that section, but that amounts paid that are not ordinary and necessary expenses, such as capital expenditures and disguised IRA contributions, are not deductible under section 212.

The analysis that applies to employer contributions to a trust to pay brokers' commissions on transactions involving qualified plan assets also applies to IRA contributions. Thus, IRA contributions to pay brokers' commissions on transactions involving IRA assets and direct payments by the IRA owner to a broker for commissions on transactions involving IRA assets are not deductible under section 162 or 212. Such contributions (and payments treated as IRA contributions) are deductible subject to the limits of section 219.

In Situation (2), the additional contributions to the IRA to reimburse the IRA for brokers' commissions result in the total IRA contributions for 1985 exceeding the amount that can be deducted under section 219 for 1985. The contributions that exceed the limits of that section are subject to the tax on excess contributions described in section 4973.

HOLDINGS

The employer contributions to the trust of the qualified plan in Situation (1) to reimburse the trust for brokers' commissions on transactions involving trust assets cannot be separately deducted as an ordinary and necessary business expense under sections 162 or 212 of the Code.

Similarly, the IRA contribution by the IRA owner in Situation (2) to pay brokers' commissions on transactions involving the assets of the IRA cannot be separately deducted under section 162 or 212 of the Code.